

Internal Revenue Service  
**memorandum**

SJBomgardner  
CC:INTL-0656-94

date:

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to:

Tom Logan, Program Analyst, IN:I:A

from:

Charles P. Besecky, <sup>CPB</sup>Chief, Branch 4  
Sharon J. Bomgardner

subject:

This is in response to your request for assistance regarding whether liquidating distributions to be made by [REDACTED] to the [REDACTED] should be subject to withholding under section 1445 of the Internal Revenue Code. [REDACTED] claims that the distributions should not be subject to withholding under section 1445(e) because they will not generate unrelated business taxable income ("UBTI") under section 512 for the [REDACTED]

We have coordinated with CC:DOM:EBEO regarding the application of sections 501, 511 and 512, and with CC:DOM:CORP regarding the application of sections 331 and 332.

**Facts**

[REDACTED] is a U.S. holding company whose assets consist primarily of indirect interests in U.S. real property. The U.S. real property is held through wholly owned U.S. subsidiaries that own interests in U.S. partnerships. [REDACTED] is a U.S. real property holding company ("USRPHC") under section 897(c)(2) because the fair market value of its U.S. real property interests ("USRPIs") is greater than 50% of the total fair market value of all of its assets. [REDACTED] has represented that it is a holding company exempt from federal income tax under section 501(c)(2).

[REDACTED] common stock is [REDACTED]% owned by the [REDACTED] a foreign entity and an official body of the [REDACTED] that is exempt from U.S. income taxation under section 501(c)(3).<sup>1</sup> [REDACTED] has no other outstanding classes of stock.

<sup>1</sup> The [REDACTED] received a determination from the Service dated [REDACTED], concluding that it is exempt from federal income tax under section 501(c)(3).

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██████████ intends to adopt a plan of liquidation pursuant to which it will sell all of its U.S. real property (and interests in U.S. real property), and distribute the proceeds to the ██████████. ██████████ has requested a withholding certificate exempting it from its withholding requirements under section 1445(e)(3) on the basis that the ██████████ will have no UBTI attributable to the liquidating distributions and is exempt from U.S. tax on such distributions.

#### Issues

- (1) Whether the ██████████ will have no UBTI attributable to the liquidating distributions and will therefore be exempt from U.S. tax on such distributions.
- (2) If so, whether a withholding certificate should be issued.

#### Analysis

##### Issue (1)

In order to determine whether the ██████████ will be exempt from U.S. tax on the liquidating distributions, first it is necessary to determine whether section 332(a) applies to the distributions. Under section 332(a), a corporation recognizes no gain or loss on the receipt of property in complete liquidation of another corporation if the requirements of section 332(b) are satisfied. CC:DOM:CORP has concluded that section 332(a) applies, and that the ██████████ will recognize no gain or loss upon receipt of the distributions.<sup>2</sup>

Second, it is necessary to determine whether the FIRPTA provisions under section 897 apply to change this conclusion. Section 897(a) treats a foreign corporation's gain from the "disposition" of a USRPI (including stock in a USRPHC) as if the corporation were engaged in a trade or business in the United States, and as if the gain were effectively connected with such trade or business ("ECI").

In this case, because the ██████████ will recognize no gain on the distributions under section 332(a), it will have no gain from the "disposition" of a USRPI under section 897(a) unless section 897(e) applies. Under section 897(e),

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<sup>2</sup> ██████████ has made the representations required by Rev. Proc. 90-52, 1990-2 C.B. 626, which sets forth the information and representations that must be included in a request for a ruling under section 332. The ██████████ has represented that it is a "corporation" as defined in section 7701(a)(3). CC:DOM:CORP has expressed no opinion concerning whether the ██████████ is a "corporation."

nonrecognition provisions such as section 332(a) do not apply to certain exchanges of USRPIs. See section 1.897-6T(a). However, in this case, section 897(e) does not preclude the application of section 332(a). The regulations under section 897(e) specifically provide that in a section 332(a) liquidation of a USRPHC into its foreign corporate shareholder, a shareholder that meets the stock ownership requirements of section 332(b)<sup>3</sup> will recognize no gain under section 897(e)(1) or section 367(a) on the receipt of property. Section 1.897-5T(b)(3)(iv)(A); section 1.897-5T(b)(5), Example 3 (the disposition of subsidiary stock is not treated as a disposition of a USRPI). Therefore, the [REDACTED] will recognize no gain or loss on the liquidating distributions under section 332(a).

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CC:DOM:EBEO has concluded that since the [REDACTED] will recognize no gain or loss under section 332(a) on the liquidating distributions, it will have no UBTI attributable to the liquidation. Thus, the [REDACTED] income from the distributions will be exempt from U.S. tax.<sup>4</sup>

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<sup>3</sup> [REDACTED] has represented that the [REDACTED] meets the stock ownership requirements of section 332(b).

<sup>4</sup> If section 332(a) were not applicable to the liquidating distributions, section 331(a) would be applicable. Under section 331(a), amounts received by a shareholder in a distribution in complete liquidation of a corporation are treated as in full payment in exchange for stock. Thus, a shareholder ordinarily recognizes gain or loss on amounts received as liquidating distributions under section 331(a). A foreign shareholder is ordinarily taxable on gain or loss from liquidating distributions received in exchange for the stock of a USRPHC, and such gain or loss is treated as effectively connected with a U.S. trade or business. See section 897(a); section 1.897-5T(b)(2)(iii).

A foreign section 501(c) shareholder is taxed on UBTI that is effectively connected with the conduct of a U.S. trade or business. See section 512(a)(2). A foreign section 501(c) shareholder's gain or loss on a section 331(a) liquidating distribution, which is ordinarily taxable under section 1.897-5T(b)(2)(iii), is generally not UBTI since the amounts received in the distribution are treated as received "in full payment in exchange for stock," and under section 512(b)(5), gain from the sale, exchange, or other disposition of property is generally excluded from UBTI. Thus, section 512(b)(5) applies to exclude a foreign section 501(c) shareholder's gain under section 897(a) from being taxed under section 512(a)(2).

**Issue (2)**

Section 1445(e)(3) requires a USRPHC that distributes property to a foreign person<sup>5</sup> in a transaction to which section 302 applies, or to which sections 331 through 346 apply, to withhold a tax equal to 10 percent of the amount realized by the foreign shareholder. The distributing corporation is not required to withhold if, as of the date of the distribution, interests in such corporation are not USRPIs by reason of section 897(c)(1)(B), i.e., if gain has been recognized by the corporation on all of the USRPIs.

Section 1.1445-6(a)(1) provides that a withholding certificate may be issued in cases where adjusted withholding is appropriate (e.g., where the relevant taxpayers are exempt from U.S. tax). Section 1.1445-6(d)(1) provides that the Service will issue a withholding certificate that excuses withholding by an entity or a fiduciary if it is established that a relevant taxpayer's income from the transaction will be exempt from U.S. tax.

Rev. Proc. 88-23, 1988-1 C.B. 786, provides the procedure for obtaining a withholding certificate under section 1.1445-6. Rev. Proc. 88-23 provides that a withholding certificate may be issued by the Service in cases where the transferor is exempt from U.S. tax. To facilitate the processing of applications for withholding certificates, the revenue procedure divides all applications into six categories. Category 1 applications are applications for withholding certificates based on a claim that the transferor is entitled to nonrecognition treatment or is exempt from tax. In this case, the application does not expressly qualify as a Category 1 application because it does not fall within one of the two exemptions described in 1.1445-6(d)(2). It may, therefore, be dealt with as a Category 6 application (an application for withholding on any other basis). See section 4.10(2). The fact that it may not qualify as a Category 1 application does not preclude it from qualifying as a Category 6 application.

This application is analogous to a Category 1 application because the [REDACTED] income from the distributions will be exempt from U.S. tax. It is therefore appropriate to issue a withholding certificate.

Shortly after obtaining a withholding certificate, [REDACTED] will adopt a plan of liquidation specifying that the final liquidating distribution is to be completed within 3 years from the close of the taxable year of [REDACTED] in which the first

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<sup>5</sup> Section 1.897-9T(c) defines "foreign person" to include a foreign corporation.

liquidating distribution is made. See section 332(b)(3). We recommend issuing a withholding certificate that covers distributions within this 3 year period. During the period that the withholding certificate is in effect, [REDACTED] must continue to be exempt from federal income tax under section 501(c)(2), and the [REDACTED] must continue to be exempt from federal income tax under section 501(c)(3).

If you have any further questions or comments, you may contact Sharon Bomgardner or Charlie Besecky on 622-3860.